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No. 642

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Supreme Court of the United States

October Term, 1966

BALTIMORE AND OHIO RAILROAD COMPANY, et al.,

Appellants

v.

UNITED STATES OF AMERICA, et al.,

Appellees

On Appeal from the United States District Court for the Southern District of New York

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JURISDICTIONAL STATEMENT

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JURISDICTIONAL STATEMENT

Appellants The Baltimore and Ohio Railroad Company, The Central Railroad Company of New Jersey, The Chesapeake and Ohio Railway Company, Norfolk and Western Railway Company, Reading Company, and Western Maryland Railway Company, appeal from the judgment of the United States District Court for the Southern District of New York, entered on October 4, 1966, denying appellants' motions for interlocutory injunction to enjoin the enforcement, operation and execution of certain orders of the Interstate Commerce Commission, and submit this Statement to show that the Supreme Court of the United States has jurisdiction of the appeal and that substantial questions are presented.

Opinion Below

The majority and dissenting opinions of the three-judge United States District Court for the Southern

District of New York are not yet reported. Copies of the opinions are attached hereto as Appendix A. The report and order of the Interstate Commerce Commission, dated April 6, 1966, are reported at 327 I.C.C. 475. The report and order of the Interstate Commerce Commission on reconsideration, dated September 16, 1966, are not yet reported. A copy of the Commission's report and order on reconsideration is attached hereto as Appendix B. The Commission's further order dated September 29, 1966, setting hearings in these proceedings is attached hereto as Appendix C.

Jurisdiction

This suit was brought under Title 5, U.S.C. § 1009, and Title 28, U.S.C §§ 1336, 2284 and 2321-25, to annul and set aside in part an order of the Interstate Commerce Commission dated April 6, 1966, as modified by its order dated September 16, 1966, and to obtain injunctive relief. The order of the district court, denying the motions for an interlocutory injunction, was entered on October 4, 1966. Notice of appeal was filed in that court on October 6, 1966. The jurisdiction of the Supreme Court to review this order by direct appeal is conferred by Title 28, U.S.C. §§ 1253 and 2101(b).

Questions Presented

1. Whether the district court erred in assuming that the Commission could fashion effective and lawful conditions to the Penn-Central merger to protect the other Eastern railroads even though the Commission made no finding that such conditions could be formulated?

2. Whether Section 5(2) of the Interstate Commerce Act requires the Commission to determine the legality and propriety of essential conditions to a merger before such merger is consummated?

3. Whether the district court erred in substituting its own grounds to justify immediate consummation of the Penn-Central merger after holding that the ground relied upon by the Commission itself could not be sustained?

4. Whether the district court erred in holding that the Commission's rescission of protective conditions in the Penn-Central merger was supported by adequate findings, even though the Commission had earlier found those conditions to be essential to consummation of the merger and failed to explain why it changed its position?

5. Whether the district court erred in holding that a reviewing court can compel the Interstate Commerce Commission to prescribe appropriate protective conditions to the Penn-Central merger, so that appellants are not faced with irreparable injury in the form of a loss of the right of effective judicial review from consummation of that merger prior to the prescription of conditions by the Commission?

6. Whether the district court erred in holding that appellants are not faced with irreparable injury from consummation of the Penn-Central merger, even though appellants will be immediately and adversely affected by consummation of the merger?

7. Whether the district court erred in holding the balance of equities to be in favor of consummation of the merger because Penn-Central agreed to waive review of most but not all of the conditions to be prescribed by the Commission on further hearing and the other railroads did not?

8. Whether the district court erred in assessing the public interest in an interlocutory injunction with-

out giving any effect to the impact of the merger on other railroads or the anti-competitive aspects of the merger as conditioned?

Statutes Involved

The statutes involved in this case are: Administrative Procedure Act, Sections 5, 8(b), 10(c), 10(d), 10(e); 5 U.S.C. §§ 1004, 1007(b), 1009(c), 1009(d), 1009(e); Judicial Code, 28 U.S.C. §§ 1253, 1336, 2101(b), 2284, 2321-25; Interstate Commerce Act, Sections 5(1), 5(2), 5(9); 49 U.S.C. §§ 5(1), 5(2), 5(9). The text of these statutes is attached hereto as Appendix D.

Statement

This is an appeal from an order of the United States District Court for the Southern District of New York denying an interlocutory injunction against an order of the Interstate Commerce Commission which approves and permits the consummation of a merger between The Pennsylvania Railroad Company and The New York Central Railroad Company. Appellants are six Eastern railroads referred to collectively in the majority opinion below as the "unprotected carriers" (Appendix A, p. 11). The other Eastern railroads involved in this case are the Erie-Lackawanna, Delaware and Hudson and Boston and Maine, referred to collectively in the majority opinion as the "protected carriers" (*ibid.*) and the Pennsylvania, New York Central and New Haven, which comprise the contemplated Penn-Central system.

The Pennsylvania and the New York Central are already the two largest railroads serving the Eastern part of the United States. Because of the size of the rail-

roads involved and their present dominance in large portions of the East, the Penn-Central merger application raised a number of problems, the most serious of which was the effect of such a merger upon the traffic and revenues of the smaller Eastern railroads. These smaller roads presently depend upon routes they maintain with the Pennsylvania and New York Central for a substantial part of their traffic, but the availability of single-line service over the merged Penn-Central system to nearly every important point in the East will inevitably make the multiple-line routes of these smaller carriers less attractive to shippers. To the extent that the powerful new system will be able to control the routing of traffic, such traffic would certainly be diverted away from multiple-line routes, from which Penn-Central would get only a portion of the revenue, to the single-line route, which would accord Penn-Central all of the revenue accruing from such rail service.

Although virtually every railroad of any substantial size in the East is threatened with some traffic diversion as a result of the Penn-Central merger, the Commission's Examiners recommended approval of the merger without any extraordinary protective conditions. It was their view "that while approval of this merger and improved service brought about thereunder will undoubtedly result in a shifting of traffic patterns," this loss of traffic will be offset by "the creation of new traffic relationships between such non-participating carriers, their affiliates and non-aligned carriers, [so] that the net effect will not be detrimental to such carriers" (Examiners' Recommended Report, p. 305).

In its report and order of April 6, 1966, the Commission adopted the approach recommended by its Examiners as to most of the Eastern railroads and, as to these railroads, it incorporated the Examiners' finding that the traffic to be lost would be offset by "the creation of new traffic relationships between such non-participating carriers, their affiliates and non-aligned carriers, [so] that the net effect will not be detrimental to such carriers" (327 I.C.C. at 481). As to three railroads, however, the Erie-Lackawanna, Delaware and Hudson and Boston and Maine, the Commission rejected its Examiners' approach and prescribed a series of protective conditions assertedly designed to protect the revenues, and to some extent the traffic, of these three railroads from the harmful effects of consummation of the merger (327 I.C.C. at 529, 531-532).

The heart of the protection afforded to the Erie-Lackawanna, Delaware and Hudson and Boston and Maine in the Commission's April 6th report and order was a formula designed to guarantee those three railroads the same proportionate ratio of earnings as compared to the merged Penn-Central system as they had enjoyed in competition with the Pennsylvania and New York Central, as separate railroads, prior to the merger. The premise of this arrangement was that the new Penn-Central system would divert substantial amounts of freight traffic from the "protected carriers." To offset this freight diversion, the protective conditions provided that the Penn-Central system would make annual payments to each of the "protected carriers" to the

extent of any diminution in the proportion of the total revenues handled by them and the Penn-Central system as compared to the proportion of the total revenues of these three railroads and the components of the Penn-Central system in the year 1964.[1] In its April 6th report, the Commission expressly found the protection afforded the Erie-Lackawanna, Delaware and Hudson and Boston and Maine to be critical to its order approving the consummation of the merger (327 I.C.C. at 532):

> "It is doubtful that, without inclusion in a major system, these three carriers could withstand the competition of the applicants merged, and, unless they are protected during the period necessary to determine their future, we would not authorize consummation at this time, even though approving the merger."

Although the immediate purpose of the "indemnity" arrangement was to protect the Erie-Lackawanna, the Delaware and Hudson and the Boston and Maine against the financial losses they would suffer if traffic now being handled by those railroads is diverted to the Penn-Central system as a result of the merger, the arithmetic of the formula is such that the "protected carriers" would receive payments from Penn-Central as a result of the diversion of traffic from *other* Eastern railroads to the

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[1] On the basis of the freight revenue figures for that year, the Commission found that the Erie-Lackawanna was entitled to a guaranty (called an "indemnity") based upon a proportion of 13.0967 percent, the Delaware and Hudson to an "indemnity" based upon a proportion of 3.2819 percent and the Boston and Maine to an "indemnity" based upon a proportion of 4.2578 percent of the combined revenues (327 I.C.C. at 533).

Penn-Central system.[2] The Commission's "indemnity" arrangement thus amounted to far more than a mere protection of the Erie-Lackawanna, the Delaware and Hudson and the Boston and Maine against losses of revenues resulting from diversions of their traffic to a merged Penn-Central system. Indeed, the "indemnity" arrangement would have created a complete community of interest between the Penn-Central system, on the one hand, and the "protected carriers" on the other. To the extent that the "protected carriers" could divert traffic from other Eastern railroads to the Penn-Central system, they could increase the amount of their "indemnities." And to the extent that the Penn-Central system could divert traffic from other Eastern railroads to the "protected carriers," the amount of these "indemnities" could be reduced.

This community of financial interest created between the Penn-Central system and the "protected carriers" by the Commission's "indemnity" arrangement completely undercut the Commission's finding that the losses to be suffered by the "unprotected carriers" would be offset by new traffic relationships created among non-participating railroads. Indeed, because of this com-

[2]This can be illustrated by assuming that the 1967 freight revenues of the three protected railroads remain the same as they were in 1964 while the revenues of the Penn-Central system increase by $30 million over 1964 by reason of traffic diverted to it from other Eastern railroads (including appellants). The formula would reward the three protected railroads with "indemnities" totalling $1,404,000 for revenues lost to the Penn-Central system by other Eastern railroads (including appellants). As a result of this formula, therefore, the three protected railroads, each of which now is engaged in active competition with Pennsylvania and New York Central via routes in which appellants participate, would, for the first time, have a financial incentive to route traffic *away* from appellants' routes and over to Penn-Central in order to increase the "indemnity" payments.

munity of financial interest, the "unprotected carriers" not only faced the prospect that traffic lost as a result of the merger would not be offset, but also were threatened with an additional loss of traffic as a result of the "indemnity." Accordingly, the "unprotected carriers" petitioned the Commission for reconsideration of and further hearings on the report and order of April 6, 1966, pointing out that the "indemnity" arrangement would have such an effect and that no hearing had been held and that the record contained no evidence with respect to the effect of such an arrangement. At the same time, these carriers asked that the Commission postpone consummation of the merger until such further hearings were completed and the problem of protection for other Eastern railroads had been worked out.

The statutory defendant, the United States, took the position before the Commission that the normal procedure of determining protective conditions *before* consummation of a merger should not be abandoned in this case. In the view of the United States, the failure to follow regular procedures would create serious doubts as to the soundness in policy and law of the Commission's action. In any event, if the Commission departed from the normal procedures, the United States maintained that Penn-Central should be bound to accept, "without further litigation," "any protective conditions the Commission might impose after rehearings," including a capital indemnity condition. (Reply of the United States of America in I.C.C. Finance Docket No. 21989-90, August 8, 1966, pp. 4-5.)

Although the order permitting the merger was scheduled to become effective on September 30, 1966, the Commission did not act on these petitions until September 16, 1966. By that time, both the "protected carriers" and the "unprotected carriers" had sought judicial relief against the order of April 6th in a series of separate complaints filed in the district court. Each of these actions sought to enjoin consummation of the merger and, to that end, each group of the plaintiffs filed concurrently with its complaint motions for a temporary restraining order and an interlocutory injunction.

The Commission's supplemental report and order on reconsideration of September 16th were specifically directed to the pending court action. The supplemental report and order "rescinded" the "indemnity" arrangement pending hearings at which all interested parties will be heard with respect to its ramifications (Appendix B, p. 39). The Commission specifically found, however, that any indemnity payments will be retroactive to the date of consummation of the merger (Appendix B, p. 40), and concluded that, in prescribing an indemnity arrangement, it was under no obligation to meet the standards of the anti-pooling provisions of the Interstate Commerce Act (49 U.S.C. § 5(1)) (Appendix B, p. 35).

The Commission refused to postpone consummation of the merger pending the completion of the hearings and the determination of protective conditions for the other Eastern railroads. Yet the September 16th report contained no findings as to how the Commission expected

to accomplish its purpose of protecting the Erie-Lackawanna, Delaware and Hudson and Boston and Maine without injuring the "unprotected carriers" in the East, nor did the Commission even find that this would be possible. This action was a clear departure from the normal procedure the United States urged the Commission to follow. Penn-Central was not even bound to accept all the conditions that might subsequently be imposed. Accordingly, by supplemental complaints filed September 21, 1966, appellants challenged the lawfulness of the Commission's supplemental report and order and, at the same time, renewed their requests for a temporary restraining order and an interlocutory injunction. The United States, the statutory defendant, did not undertake to defend the Commission's action.

At the hearing held before the three-judge district court on September 21, 1966, the court issued a temporary restraining order pending its determination of the motions for an interlocutory injunction. However, by opinion and judgment dated October 4, 1966, the district court, one judge dissenting, denied all motions for an interlocutory injunction. This appeal followed.

THE QUESTIONS PRESENTED ARE SUBSTANTIAL

The questions presented by this appeal arise from the unprecedented action of the Commission in permitting immediate consummation of the largest railroad merger of all time before determining the conditions to that merger which are critical to the competitors of the merged system. It should be apparent that a merger of

the largest and second largest railroads in the East is certain to have an enormous impact upon the competitors of those railroads. The Commission recognized this fact, for that is precisely why it initially prescribed the conditions described by the court below as "unprecedented in their severity in the history of railroad mergers" (Appendix A, p. 9). The purpose of appellant railroads in bringing this action is to protect themselves and the public they serve from the substantial harm that would be inflicted upon them, until the Commission can complete the task, which it found to be essential, of formulating protective conditions which are lawful and do not impose injury upon appellant "unprotected carriers."

The questions presented are plainly substantial when the Commission's action here is measured against previous administrative practice. Notwithstanding the recognized gravity of the threat posed by Penn-Central to its competitors, the Commission has left the task of protecting those competitors up in the air. Even in small mergers, with consequently much smaller dangers to competitors, the Commission has invariably settled the question of protection prior to merger. Here, however, in the biggest merger in the history of American industry, the Commission has simply put the matter off to another day. This alone establishes the substantiality of this appeal.

I. THE DISTRICT COURT ERRED IN ASSUMING, WITHOUT ANY FINDING BY THE COMMISSION, THAT THE PROBLEMS CAUSED OTHER EASTERN RAILROADS BY THE PENN-CENTRAL MERGER CAN BE WORKED OUT AFTER THE CONSUMMATION OF THE MERGER.

The basic error of the Interstate Commerce Commission in this case is its failure to provide essential protection for other Eastern railroads affected by the Penn-Central merger prior to the consummation of that merger. The fact that the merger would have a substantial effect upon other railroads was undisputed and the Commission itself so recognized. The Commission's Examiners recognized this when they recommended approval of the merger on the theory that the detrimental effects upon other railroads would be offset by the incentives these railroads would have to cooperate among themselves. The Commission acted upon the same recognition when it adopted this finding with respect to the appellant "unprotected carriers" and went even further insofar as the Erie-Lackawanna, Delaware and Hudson and Boston and Maine were concerned and held that these three "protected carriers" were entitled to special protection beyond that afforded to other carriers.

In abandoning the special protective conditions prescribed for Erie-Lackawanna, Delaware and Hudson and Boston and Maine in the September 16th supplemental report, the Commission has left those carriers without the very protection to which it originally held them to be entitled. Yet by holding out the prospect

of an indemnity arrangement retroactive to the date of consummation of the merger after the further hearings to be held are completed, the Commission has precluded the possibility that those railroads will in fact cooperate with the "unprotected carriers." As a result, neither the "unprotected carriers" nor the "protected carriers" have been afforded any real protection against the detrimental effects of the Penn-Central merger. Quite to the contrary, the "unprotected carriers" and the "protected carriers" are left to fight among themselves for whatever protection might ultimately be afforded in the further hearings to be held. An inevitable result of such a fight would be that both the "unprotected carriers" and the "protected carriers" would suffer substantial harm while the Penn-Central system, their already dominant competitor, becomes even more powerful.

Suppose that, following a hearing, it should appear that it is not feasible simultaneously to protect the three "protected carriers" from the impact of Penn-Central by an arrangement which does not, at the same time, adversely affect the "unprotected carriers" and have serious anti-competitive effects. The Commission assumes that, somehow, in some way, it can reconcile all of the interests to be protected. The court below refuses to "take seriously the dismal forecast that it is even conceivable that this is not possible" (Appendix A, p. 36).[3] But plainly it is possible and, if such a possibility exists,

[3] The most the court below could say affirmatively, however, was that, when the Commission's hearings and further consideration have been completed, "we *may* find provisions carefully tailored to prevent or at least minimize the feared manipulation or, conceivably, financial provisions of an entirely different character . . ." (Appendix A, p. 26). (Emphasis added.)

consummation of the Penn-Central merger at this time would be contrary to the public interest and cause irreparable harm.

As things now stand, the Commission has open to it at least three alternatives if it finds that all of the conflicting interests at stake here cannot be reconciled. It can cut back on the protection accorded the "protected carriers," it can force the "unprotected carriers" to absorb additional injury, or it can delay the consummation of Penn-Central. Once Penn-Central is consummated, however, this last alternative would no longer be open to the Commission and it would be forced to choose between withdrawing protection from the "protected carriers" or inflicting injury upon the "unprotected carriers." And this would be so regardless of what the evidence adduced at the further hearings to be held might show. Even if the evidence were clear that the best alternative from the standpoint of the public interest in maintaining the whole railroad system of the East would have been to delay the merger, the Commission can only choose between the other alternatives. Thus, consummation of the merger inevitably threatens both the "protected railroads" and the "unprotected railroads" with undue injuries which would not otherwise be necessary.

Such an impasse is not only possible, but likely, as can be shown from the Commission's September 16th report. The only form of protection yet suggested for the three "protected carriers" is a revenue pool of the type prescribed in the April 6th report. The three "protected carriers" embraced the concept of a revenue pool and objected to the April 6th condition only on the

ground that the terms of the pool should be sweetened for their benefit (Appendix B, pp. 37-39). The hearing set by the Commission will consider such claim, and any indemnity payment will be retroactive to date of consummation of the merger (Appendix B, pp. 41-42, 44).

The "unprotected carriers" will be adversely affected by any revenue pool. These appellants contend that the proposed revenue pool violates Section 5(1) of the Interstate Commerce Act (49 U.S.C. § 5(1)), which sharply limits the power of the Interstate Commerce Commission to approve "agreements" or "combinations" for the "pooling" or "division" of traffic or revenues. Section 5(1) provides that before a pooling combination shall be approved, the Commission must make express findings that such an arrangement "will be in the interest of better service to the public or of economy in operation and will not unduly restrain competition" (49 U.S.C. § 5(1)). The Commission held that it has power under Section 5(2) of the Act to approve pooling combinations without regard to the necessity for evidence and findings as required by Section 5(1) (Appendix B, p. 39), but this finding is clearly at variance with established law. *Chicago & Northwestern Ry. v. Peoria & P.U. Ry.*, 201 F. Supp. 241 (S.D. Ill. 1962), *aff'd*, 319 F.2d 117, 122 (7th Cir. 1963), *cert. denied*, 375 U.S. 969 (1964).

Although the Commission is proceeding under the unlawful premise that it can protect three carriers by a revenue pool that does not meet the standards of Section 5(1), the district court suggested that "the Commission may decide to make findings under Section 5(1)" (Appendix A, p. 26). But even if the Commission, contrary

to its September 16th report, does undertake to make the findings required by Section 5(1), how can it assume now, before any hearing, that there will be any evidence to support such findings?

Under these circumstances, it is a mere assumption, unsupported by any record, that the Commission can somehow fashion in the future the protective conditions found to be essential to the consummation of the Penn-Central merger. The Commission has had two chances to formulate lawful conditions and it has not produced them thus far. Yet the Commission and the district court have prejudged the question of whether it is feasible to formulate conditions which will reconcile all of the conflicting interests in a lawful manner. But if this faith and optimism should prove unjustified by the record to be developed, either the "protected carriers" or the "unprotected carriers," or both, will have been irreparably damaged. Meanwhile, Penn-Central would have been consummated and would have benefited from unlawful conditions. By permitting consummation of Penn-Central before deciding upon the essential conditions to the merger, the Commission has restricted the alternatives available to it and, having boxed itself in, cannot accord a fair hearing to the unprotected railroads.

The situation is even more untenable with respect to the issue of a capital indemnity as to which Penn-Central is permitted to reserve the right of judicial review (Appendix B, p. 43). The other protective conditions to be considered by the Commission are only to be effective for an interim period during which the ultimate future of the protected railroads—their inclusion in an-

other major railroad system—is to be considered and determined (Appendix B, p. 40). But it is manifestly impossible to accomplish such a restructuring of these Eastern railroads until the issue of whether there is to be a capital indemnity, and its amount, are finally decided because this affects the financial terms for the inclusion of these protected railroads in another system. The very existence of the right of judicial review on the issue of capital indemnity enables Penn-Central, after its own merger has been consummated, to delay and, if successful, defeat, an essential factor in the restructuring of other Eastern railroad systems including both "protected" and "unprotected carriers."

None of the threats of irreparable injury would have arisen if the Commission had complied with the requirement of the Interstate Commerce Act that consideration of the effect of mergers upon other carriers be accorded *prior* to consummation of the merger. Indeed, this is absolutely necessary for the Commission properly to discharge its ultimate responsibility under Section 5(2) of the Interstate Commerce Act to find that the whole transaction, including "such terms and conditions and such modifications as it shall find to be just and reasonable" is "consistent with the public interest." The Commission cannot determine that a merger package is consistent with the public interest unless and until it determines the essential elements of that package.

To permit an administrative agency to act first, and attempt to provide protection against the consequences

of its action later, inevitably results in downgrading the process of providing protection to one of rationalizing action already taken. In *Scenic Hudson Preservation Conference* v. *Federal Power Comm'n*, 354 F.2d 608 (2d Cir. 1965), *cert. denied*, 384 U.S. 941 (1966), the Court of Appeals set aside an order of the Federal Power Commission which failed to determine protective conditions before the licensing of a power project. The Federal Power Commission had set for hearing the question of what protection was to be given, but it nevertheless allowed the project to begin before finding that any protective device would be adequate. The Court of Appeals held that the license had been granted on an inadequate record and without consideration of possible alternative plans and that the question of protection must be decided *before* deciding whether the project is to be licensed (354 F.2d at 624).

The *Scenic Hudson* case emphasizes the problem which is most serious here. The Commission has recognized the need for protection of other Eastern railroads against the effects of the Penn-Central merger, as, indeed, it was compelled to recognize the need for such protection by Section 5(2)(c) of the Interstate Commerce Act. Yet the Commission has permitted consummation of the merger without finding how such protection could be afforded some railroads without so adversely affecting other railroads as to imperil their ability to serve the public, and without even finding that such protection is possible after the merger has been consummated.

II. THE DISTRICT COURT ERRED IN UPHOLDING THE COMMISSION'S ACTION ON GROUNDS NOT RELIED UPON BY THE COMMISSION AND WHICH ARE NOT SUPPORTED BY REASONED FINDINGS.

In its original report of April 6, 1966, the Interstate Commerce Commission expressly found that the indemnity arrangement prescribed for the protection of the Erie-Lackawanna, Delaware and Hudson and Boston and Maine was an absolute prerequisite to consummation of the Penn-Central merger (327 I.C.C. at 532):

> "It is doubtful that, without inclusion in a major system, these three carriers could withstand the competition of the applicants merged, and, unless they are protected during the period necessary to determine their future, we would not authorize consummation at this time, even though approving the merger."

In its supplemental report of September 16th, the Commission abandoned this finding and "rescinded" the indemnity arrangement prescribed for the "protected carriers" because no hearing had been held and no evidence was available to justify such an indemnity. Accordingly, the critical issue before the Commission in its September 16th report was whether to permit immediate consummation of the Penn-Central merger or to delay consummation for a matter of months until protective conditions for other railroads had been considered following a hearing. The decisive finding addressed to this crucial point was the following (Appendix B, p. 16):

> ". . . we are not prepared to take the risks which delay of consummation of even six or twelve months

might entail in providing a solution of the New Haven problem other than liquidation."

Although the court below unanimously rejected the New Haven situation as a basis for immediate consummation of the Penn-Central merger (Appendix A, pp. 21-23, 62-63), it nevertheless permitted consummation of the merger on its own theory that this was consistent with the public interest on other grounds. Putting aside for the moment the grounds invoked by the district court to justify the Commission's action, it is nonetheless plain that whatever the precise nature of those grounds might be, the district court acted improperly in relying upon them. It is settled that a reviewing court must act on the basis of the findings of the agency itself, and may not supply alternative grounds for decision; administrative action must be upheld, if at all, only on the grounds adopted by the agency. *Burlington Truck Lines* v. *United States*, 371 U.S. 156, 168-169 (1962); *Securities & Exchange Comm'n* v. *Chenery Corp.*, 332 U.S. 194, 196 (1947). This principle forbids a reviewing court from supplying a rationale in place of the one articulated by the Commission itself and thus flatly condemns the action of the district court here.

When the grounds upon which the district court did choose to uphold the action of the Commission are considered, the unlawfulness of its decision is even more apparent. For the court relied upon general findings made by the Commission in its original report to the effect that the merger as then conditioned was in the public interest, and these general findings are themselves

legally inadequate as applied to the changed circumstances brought about by the "rescission" of the initially prescribed indemnity arrangement. The failure of the Commission to make specific findings as to requirements of the public interest under the new conditions itself constitutes a ground requiring that the Commission's action be set aside.

The protection to be afforded other Eastern railroads was plainly a material issue in the proceedings before the Commission; indeed, such protection is an ultimate statutory issue under Section 5(2)(c) of the Interstate Commerce Act. The Commission's failure in its September 16th report to discuss this issue and make reasoned findings with respect to it constitutes a classic violation of Section 8(b) of the Administrative Procedure Act which requires that the Commission make reasoned findings on all material issues. *Burlington Truck Lines* v. *United States*, 371 U.S. 156, 167-168 (1962).

This defect would vitiate the September 16th report if the April 6th report had never been issued. However, the September 16th report is even more defective in that it also constituted a departure from the Commission's previous report. It is well settled that although an administrative agency is not bound by its previous decisions and can change principles previously decided, even as between the same parties, it must provide a rational explanation for such a change of mind. *Secretary of Agriculture* v. *United States*, 347 U.S. 645, 652-653 (1954).

The district court held that the Commission could "change its mind on the method best adapted to obtain

its objectives" without any explanation at all (Appendix A, p. 24). According to the district court, the Commission is not bound to make reasoned findings on all material issues as required by Section 8(b), or to explain its departure from all previously established principles as required by the *Secretary of Agriculture* case. In the district court's view, the Commission may do what it sees fit without explanation except with respect to certain findings termed "vital" (Appendix A, pp. 24-25).

There is no authority, statutory or judicial, and the district court certainly cites none, which would justify a limitation of the responsibility of an administrative agency to make reasoned findings and explain its actions to "vital" issues. Indeed, Section 8(b) of the Administrative Procedure Act was passed for the express purpose of expanding the obligation of administrative agencies to make findings beyond any such vague and unenforceable standard.

III. THE DISTRICT COURT ERRED IN HOLDING THAT IT HAD POWER TO COMPEL THE COMMISSION TO PRESCRIBE APPROPRIATE PROTECTIVE CONDITIONS.

One cause of irreparable injury from the immediate consummation of the Penn-Central merger arises from the fact that consummation of the merger at this time would preclude effective judicial review of any subsequent order of the Commission following the further hearings to be held on the protective conditions. The inadequacy of review of such conditions after consummation of the merger is apparent. The power of a court

reviewing an order of the Interstate Commerce Commission under 28 U.S.C. § 2284 is sharply circumscribed. It is well settled that a reviewing court can only determine whether the administrative order before it is lawful or not, and remand any proceeding involving an unlawful order to the agency for further action. *Federal Power Comm'n* v. *Idaho Power Co.*, 344 U.S. 17 (1952). Consequently, if the Commission here enters an order which fails to comply with lawful standards, as would be the case if it provided no protection at all for the Erie-Lackawanna, Delaware and Hudson and Boston and Maine, or if it provided protection for these three railroads only at the expense of inflicting harm upon the "unprotected carriers" of a nature and to an extent inconsistent with the public interest, the only alternative open to a reviewing court would be to set aside such an order and remand it to the Commission for further proceedings.

In the situation presented here, this is no remedy at all. Since the Penn-Central merger will concededly inflict substantial injury upon all the other Eastern railroads, all of those railroads face continuing harm until the Commission is able to devise proper and lawful protective conditions. So long as this matter is unresolved, all of the other Eastern railroads would suffer a continuing injury if the Penn-Central merger has been consummated. In such a situation, a railroad's right to judicial review would amount to nothing more than a right to continue to subject itself to injury. So long as no protection at all were in effect, or so long as the protection in effect bore unfairly upon either the "protected carriers" or the "unprotected carriers," the

necessary effect would be that the Penn-Central system would benefit at the expense of some or all of the other Eastern railroads.

The district court acknowledged that the limitations of judicial review presented a substantial problem to the other Eastern railroads. Accordingly, the court dealt with this problem at length in its opinion (Appendix A, pp. 28-31). However, the court dismissed the problem as one confronting appellants with no substantial threat of irreparable injury on the novel and wholly unsupported theory that a reviewing court itself could, "if it should deem these contentions to be well founded . . . *require appropriate change*" (Appendix A, p. 29, emphasis added). And the district court further held that, at least where "such narrow issues as will here be presented" (Appendix A, p. 30), a reviewing court "could inform the Commission in a way it would thoroughly understand" just what condition the reviewing court thought ought to be entered (Appendix A, p. 30).

This view of the power of a reviewing court to compel an administrative agency to prescribe a particular condition to a merger is wholly erroneous. In *Federal Power Comm'n* v. *Idaho Power Co.*, 344 U.S. 17, 20 (1952), this Court made it plain that once a reviewing court "lay bare" an error of law, its function was completed. The court can no more direct an administrative agency to prescribe a particular condition to a merger than it could direct the agency to approve the merger itself. Nor should a court attempt to "inform" an administrative agency as to how it should perform its function. The justifications for the limitations upon judicial review of

administrative action are based upon the presumed expertise of the agency. If courts under the guise of judicial review and through the threat implicit in "suggestions" are to be permitted to make decisions which are essentially administrative and within the discretion of the Commission, the limitations upon judicial review become meaningless.[4]

The district court having rested its decision upon an unlawful concept of judicial review of future Commission action, its determination that appellants would not suffer irreparable injury falls with the concept upon which it was based.

IV. THE DISTRICT COURT ERRED IN FAILING TO PROTECT APPELLANTS FROM THE SERIOUS TRAFFIC DIVERSIONS WHICH WILL COMMENCE IMMEDIATELY UPON CONSUMMATION OF THE PENN-CENTRAL MERGER.

The basic problem confronting appellants in this case is that although they are the "unprotected carriers"

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[4]The opinion of the district court also suggests that even if in a normal situation it would have no power to compel an administrative agency to take particular action, that limitation would not apply here because Penn-Central conceded that it had such power and "we will hold the defendants to that concession" (Appendix A, p. 29). But a reading of the supplemental memorandum of Penn-Central referred to by the district court as the source of this concession makes it plain that no such concession was made. Quite the contrary, Penn-Central's position was unequivocally stated to be that "When . . . the reviewing court has exercised its judicial function and found the order of the Commission invalid, it may remand the case to the Commission for further proceedings" (relying specifically upon *Idaho Power*) (Further Supplemental Memorandum of Penn-Central, p. 24). The Commission took the same position (Memorandum of the Interstate Commerce Commission, p. 18, note 7). In any event, the district court is in error in suggesting that a concession by counsel, even if made, could bestow jurisdiction upon it to issue orders to an administrative agency charged by statute with responsibility for protecting the public interest.

under the Commission's reports and orders, they face the threat of massive traffic diversions as a result of the Commission's efforts to protect the other carriers. In the district court, appellants showed that these losses would run into tens of millions of dollars in lost revenues each year.[5] And such losses will commence immediately upon consummation of the Penn-Central merger, notwithstanding the Commission's technical "rescission" of the indemnity arrangement which induces these traffic diversions pending the further hearings to be held before the Commission.

The reason for this is that, despite the "rescission" of the indemnity for the time being, the Commission has made it plain that, after hearings, the indemnity will be restored and made retroactive to the date of consummation. In this situation, the "protected carriers" can only regard revenues diverted to the indemnity pool as money in the bank. Indeed, it is doubtful that the "protected carriers" have any real choice other than to attempt in every way they can to increase the amount of their retroactive indemnities, for, faced with a merged Penn-Central system without any present revenue protection at all, those carriers would literally be fighting for their financial lives.

The threat of loss of traffic through the cooperative efforts of Penn-Central and the "protected railroads" induced by such a revenue pool adversely affects each of these appellants, as shown by affidavits of record

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[5]The suggestion that carriers attempting to protect themselves against losses of this magnitude are merely "jockeying . . . for price and position in respect of other mergers" (Appendix A, p. 32) is not only wholly unwarranted but is also based upon a fundamental misunderstanding of the impact of Penn-Central upon the railroad structure in the East. Indeed, the district court has the matter exactly reversed, for appellants' interest in other mergers stems from the same concern that forces them to seek relief in this case—namely, the necessity for protecting their competitive abilities against the proposed giant Penn-Central system.

before the district court.[6] These traffic losses would affect each appellant's ability to serve the public in varying degrees depending upon the present financial strength of the individual appellant. The most directly and severely hit would be appellant The Central Railroad Company of New Jersey. That appellant, which is currently suffering deficits at the annual rate of $7 million and is already on the verge of bankruptcy, would be subject to loss of $4.9 million of annual revenues as a result of consummation of the Penn-Central merger (Affidavit of James L. Barngrove, Jr.). The Commission, of course, has not as yet held its hearing to consider these claims. And, even if the Commission found that appellants were entitled to and could in fact be afforded protection from the impact upon them of a revenue pool, such protection "will be made effective as of the date prescribed in a modification order" (Appendix B, p. 44), thus leaving appellants exposed to irreparable injury from the date of consummation of Penn-Central until the effective date of a further order of the Commission.

The district court discussed the nature of the revenue pool or "indemnity" formula which the Commission has held out to the three "protected railroads" (Appendix A, p. 26). The court below rejected the claim of the

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[6]The holding of the court below that: "It was undisputed that, even without the special traffic conditions, some time must pass before the merger would have serious adverse effect on anyone." (Appendix A, p. 30), does not relate to the effect of the indemnity arrangement on the unprotected carriers. Moreover, the Commission's holding that indemnity payments would be retroactive to date of consummation (Appendix B, p. 44) shows that the Commission, unlike the district court, regarded protection from the date of consummation as essential for the protected carriers as well.

unprotected carriers for the following reasons (Appendix A, p. 27):

> "All that remains is the claim that the very potentiality of retroactive indemnity provisions similar to those initially prescribed will lead the protected carriers and the Transportation Company, immediately on consummation, to pursue the same diversionary tactics the complainants fear. But we cannot find, in the light of the opposing affidavits submitted by NYC, of the Commission's finding in its report on reconsideration that 'the task of implementing a merger of this size is so vast and complex that its competitive effects will be felt only gradually,' and of our subsequent discussion, that the possibility of such action for the period required for reconsideration and review poses such a serious threat of unwarranted legal injury to the unprotected carriers as to justify a temporary injunction against consummation, in the light of the countervailing factors we have outlined."

This is not a rational disposition of appellants' claim of immediate injury from loss of traffic arising from the admitted "potentiality of retroactive indemnity provisions" because: (1) the opposing NYC affiant (Affiant Patten) did not specifically address himself to the traffic diversions resulting from the indemnity formula; (2) the Commission's finding that it will take time to implement the merger has nothing to do with the traffic diversions resulting from a revenue pool as to which payments are effective on the date of consummation; and (3) the court is creating a new concept of "unwarranted legal injury" under which it would now subject appellants, including Central Railroad of New

Jersey, to immediate injury on the theory that, on a record yet to be made, the Commission might be warranted in finding that it is in the public interest to prescribe an indemnity provision that would divert traffic from the "unprotected carriers."

Plainly, it is not for a reviewing court to dismiss, as not constituting "unwarranted legal injury," an injury which is concededly real and which the Commission has not approved or even considered. The "unprotected carriers" are faced with staggering losses which will substantially affect their revenues. In the case of such carriers as appellants Central of New Jersey and Reading, which are already in serious financial condition, these revenue losses would constitute an immediate threat to their ability to provide essential rail service to the public. The Commission could not, consistent with the public interest, disregard such facts established at hearings to be held. And the district court, which is limited to invoking the statutory standards for judicial review, can hardly be permitted to approve the imposition of such injury before the Commission has even heard the matter.

V. THE DISTRICT COURT ERRED IN ITS BALANCING OF THE EQUITIES BETWEEN APPELLANTS AND PENN-CENTRAL.

The district court committed another basic error in weighing the equities in favor of the issuance of an interlocutory injunction against the harm which such an injunction would cause Pennsylvania and New York Central. The district court's conclusion was that "the net effect weighs against the plaintiffs" (Appendix

A, p. 26). This conclusion was based upon a finding that the reopened Penn-Central proceedings will be completed by the Spring of 1967 and that plaintiffs consequently cannot conceivably be subjected to any injury beyond that date, whereas "any realistic estimate of delay of consummation from an injunction pending reconsideration would take us to the end of 1967" (Appendix A, p. 27). Because the court concluded that "we are dealing with different periods of time" (Appendix A, p. 26), it held the balance of equities to be in favor of immediate consummation of the merger.

The only reason for the "different periods of time" referred to by the district court is that Penn-Central has agreed to forego judicial review of most of the conditions to be prescribed by the Commission upon further hearing while appellants and other affected Eastern railroads have not agreed to forego such a review. Hence the sole basis for the district court's decision holding that the interlocutory injunction should not issue because the balance of equities is in favor of Penn-Central is that appellants will exercise their statutory right to judicial review in the event the Commission takes action which violates its statutory duties. This ground of decision is directly contrary to law. If appellants can be punished for failing to waive their right of judicial review before they even have an opportunity to see an order of the Commission which will have substantial effect upon them, their right of review becomes meaningless. Indeed, this aspect of the district court's decision, coupled with the Commission's unprecedented decision to postpone prescription of protective conditions until

after consummation of the merger, would constitute a revolutionary change in administrative practice. If administrative orders can be left partially undone on the theory that they can be completed in the future, and if the parties can be compelled to forego their right to judicial review before such completion, administrative agencies will become virtually immune from judicial control and the statutory duties of administrative agencies will, for all practical purposes, be unenforceable.

The true balance of equities in this case lies with the issuance of an interlocutory injunction, not the denial of such injunction, for here, as in all other merger cases, review must be obtained before consummation of the merger or no effective review at all will be available. This Court recognized this fact in its recent decision in *Federal Trade Comm'n* v. *Dean Foods Co.*, 384 U.S. 597 (1966), in which the power of the Federal Trade Commission to seek and the power of the courts to grant preliminary injunctions against mergers challenged by the Federal Trade Commission under Section 7 of the Clayton Act (15 U.S.C. § 15) was upheld. As the Court observed (384 U.S. 607, note 5):

> "If consummation of the merger is not restrained, the restoration of Bowman as an effective and viable competitor will obviously be impossible by the time a final order is entered. This is not unusual. Administrative experience shows that the Commission's inability to unscramble merged assets frequently prevents entry of an effective order of divestiture."

The courts have regularly issued such stays in railroad merger cases. *Minneapolis & St. L. Ry.* v. *United States*, 165 F. Supp. 893, 901 (D. Minn. 1958), *aff'd*, 361

U.S. 173 (1959); *Canadian Pac. Ry.* v. *United States*, 158 F. Supp. 248, 251 (D. Minn. 1958); *City of Nashville* v. *United States*, 155 F. Supp. 98, 100 (M.D. Tenn.), *aff'd*, 355 U.S. 63 (1957). In entering its order staying consummation of the Seaboard-Atlantic Coast Line merger pending judicial review, the court stated in *Florida East Coast Ry.* v. *United States*, 228 F. Supp. 340, 343 (M.D. Fla. 1964):

> "I conclude that the statutory scheme as embodied in the Interstate Commerce Act, the Administrative Procedure Act, and the three-judge court provisions of Title 28, Sections 2281-2284 and Sections 2321-2325 contemplates that in the course of orderly procedure there may be judicial review of Interstate Commerce Commission orders. After administrative procedures are final, judicial review is the next orderly step.
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> The result of not enjoining the order would be to permit the merger to proceed as ordered while its legality is litigated. If these plaintiffs ultimately prevail, the resulting chaos could never be restored to order, the injury to plaintiff and intervening plaintiffs could never be repaired. Such a result is difficult for me to reconcile with a statutory scheme which, as indicated above, would appear to envision that interested parties be entitled to seek orderly and *effective* judicial review of administrative orders." (Emphasis in original.)

The district court has not cited a single case, nor have we found one, in which a railroad merger was consummated prior to judicial review. The courts have long recognized that the balance of equities in such a situation

inevitably rests with the person challenging the merger because it is useless to lock the barn after the horse is gone. The same principle should be applied here.

VI. THE DISTRICT COURT ERRED IN FAILING TO RECOGNIZE THAT THE ANTI-COMPETITIVE IMPACT OF THE PENN-CENTRAL MERGER AS NOW CONDITIONED IS CONTRARY TO THE PUBLIC INTEREST.

The district court relied repeatedly and heavily upon its view of the public interest in denying the interlocutory injunction, referring to the Commission's findings "that the transaction will permit more economical and efficient use of the applicants' transportation facilities" and that the resulting economies "will redound in large part to the benefit of shippers, and thus to the general public, either through the improved service thereby made possible or lower rates" (Appendix A, p. 16). But this view construes too narrowly the public interest.

Section 5(2)(c) of the Interstate Commerce Act expressly provides that in passing upon a merger application the Commission must consider the totality of "the effect of the proposed transaction upon adequate transportation service to the public" as well as "the effect upon the public interest of the inclusion, or failure to include, other railroads in the territory involved." Thus, the Commission is obliged to consider not only the efficiencies which the merger would produce for the Penn-Central system and those shippers dependent upon that system but also the effect of the transaction upon other railroads and upon the shippers dependent

upon those railroads for transportation service. As shown above, this is a fundamental defect in the Commission's order in this case. In its April 6th report, the Commission prescribed an indemnity arrangement which would obviously affect railroads other than those party to the arrangement. And in its September 16th report, the Commission compounded this error by placing in doubt the protection accorded the three railroads party to the arrangement while, at the same time, holding out prospects of increasing the financial incentives which harm other railroads. The Commission never having made a finding that the merger as now conditioned is in the public interest when its impact upon other railroads is considered, the district court could not properly rely upon the findings in the Commission's now largely abandoned original report as establishing any overwhelming public interest in immediate consummation of the merger.[7]

The public also has an interest in the maintenance of balanced rail competition. In its original report, the Commission discussed at length the competitive effect and offsetting considerations with respect to the merger of Penn and Central (327 I.C.C. at 503-517). But nowhere has the Commission even considered the effect on competition inherent in the indemnity revenue pool which it has sanctioned. And a further threat to rail competition was revealed during the argument of the case before the district court when counsel for Penn

[7]Moreover, as pointed out at pp. 20-21, *supra*, the finding of the Commission in its September 16th report that the public interest requires immediate consummation of the merger was related to its view of the needs of the New Haven, which has been unanimously rejected below.

and Central took the position that the traffic conditions prescribed by the Commission would preclude competition between Penn-Central and the "protected carriers" during the period in which those railroads are to be protected under the Commission's order. (Tr. 132):

> "JUDGE FRIENDLY: Do you construe the traffic conditions as preventing the merged company from using this solicitation force to get traffic routed over its lines rather than routing it over one of these three even if it doesn't do any of the things specifically named there?
>
> "MR. GRAY: If it is traffic that they are handling and have been handling, yes. We cannot do any act, take any action which would do it and certainly that is an action."

This construction of the traffic routing conditions as precluding Penn-Central from soliciting traffic from any present customer of the "protected carriers" has serious anti-competitive effects. The qualification that the prohibition against solicitation concerns traffic which the three "protected carriers" are now handling does not remove the anti-competitive effect. This principle was expressly recognized in *Sunshine Biscuits, Inc* v. *Federal Trade Comm'n.*, 306 F.2d 48 (7th Cir. 1962), dealing with the question of whether the good faith meeting of competition defense under the Robinson-Patman Act would extend to price decreases offered to new customers. The court held that a basic element of competition was the solicitation of business not only from one's own customers but from customers of other companies and that, otherwise, "competition for new

customers would be stifled and monopoly would be fostered" (306 F.2d at 52).

Under the Penn-Central construction of the catch-all provision of the traffic routing conditions of Appendix G as prohibiting Penn-Central solicitation of the present shippers of Erie-Lackawanna, Delaware and Hudson and Boston and Maine (a construction which was doubtless adopted in an effort to minimize the harm which will result to the three railroads), there will be no competition at all in the railroad industry in most of New England and New York State.

In justifying denial of an interlocutory injunction, the district court repeatedly adverted in its opinion to the findings in the Commission's original report that the merger as then conditioned was in the public interest (Appendix A, pp. 16, 17, 32). But for all that appears, these findings may represent nothing more than a determination that, *as then conditioned*, the merger would produce more good than harm. The Commission's realization that those conditions might bear unfairly upon the "unprotected carriers" caused it to abandon the indemnity arrangement, and it might well have abandoned its determination that the merger is in the public interest had it turned its attention to that question. Certainly, the plight of such railroads as the Central of New Jersey, which is already in critical financial condition and is threatened with substantial injury as a result of the Penn-Central merger, the New Haven inclusion and the sanctioned but "rescinded" indemnity arrangement (see Affidavit of James L. Barngrove, Jr.) cannot simply be ignored.

The district court's view that the public interest requires immediate consummation of the Penn-Central merger merely because that merger will effectuate certain efficiencies and economies thus ignores two basic interests of the public which are at stake here—namely, the interest in maintaining other railroads in the East and the interest in maintaining competition. It is, of course, the function of the Commission to weigh the advantages and disadvantages of a merger both from the standpoint of other railroads that might be affected and from the standpoint of the effect upon competition. But the problem here is that the Commission has not made adequate findings, or even "perceived the danger areas,"[8] in these crucial respects. Hence, far from standing for the proposition that the public interest requires consummation of the Penn-Central merger, the Commission's reports and orders make it plain that the public interest has not been sufficiently considered in this case. In such a situation, the district court erred in permitting the Penn-Central merger to go into effect before these important aspects of the public interest have been considered and made the subject of findings by the Commission.

In the final analysis, the basic defect in the Commission's report and the fundamental misapprehension of the district court is wrapped up in the district court's assertions that the ultimate desirability of a Penn-Central merger is generally recognized (Appendix A, pp. 12, 37), and that "what is in the public interest eventually is in

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[8]Florida East Coast Ry. v. United States, F. Supp. (M.D. Fla. June 8, 1966).

it now" (Appendix A, p. 17). This is simply not so, for until it is possible to consummate the Penn-Central merger without substantial adverse effects upon the other Eastern railroads, the fact that the Penn-Central merger may otherwise be desirable is irrelevant to the present situation.

CONCLUSION

For the foregoing reasons, probable jurisdiction of this appeal should be noted and the case set down for full hearing on the merits.

Respectfully submitted,

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